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Supreme Court of the United States.

OCTOBER TERM, 1930.

No. 521

COMMISSIONER OF INTERNAL REVENUE,
PETITIONER,
v.
EDITH ANDREWS LOGAN, RESPONDENT.

No. 522

COMMISSIONER OF INTERNAL REVENUE,
PETITIONER,
v.
JULIA ANDREWS BRUCE, RESPONDENT.

BRIEF FOR RESPONDENTS IN OPPOSITION TO PETITIONS FOR WRITS OF CERTIORARI.

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v.

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BRIEF FOR RESPONDENTS IN OPPOSITION TO PETITIONS FOR WRITS OF CERTIORARI.

Since the same questions are involved in both cases and since the one petition filed covered both cases, a single brief in opposition is submitted, to be considered as the brief in opposition in each case.

I. *Statement of Questions.*

In considering the petition for a writ of certiorari in this case, the question litigated below should be stated simply and free from the trammels of mathematical formulae, theoretical assumptions, recapitalizations and other elements that obscure reasoning processes.

There are two situations involved. The first is a sale of

250 shares of stock of the Andrews & Hitchcock Iron Company for a pro-rata portion or 250/4000ths of two things: (1) a cash payment of $2,200,000 and (2) a promise to pay 60 cents for each ton of ore which the purchaser of the stock would become entitled to receive thereafter, as and when mined and actually delivered.

On this branch of the case the Court below unanimously held that the respondent who sold her stock, and who made her return for income tax purposes on a cash basis, did not realize any profit taxable as income until her share of the cash down payment added to the total of the subsequent payments actually made under the contract, exceeded the March 1, 1913, value of the shares sold, the statutory basis of computing gain on the sale. There is manifestly nothing new or novel in this holding by the Circuit Court of Appeals for the Second Circuit, so well expressed in Mr. Judge Manton's opinion below. It is in strict accord with the principles governing the determination of gain or loss for income tax purposes on sales of stock and capital assets, frequently expressed by this Court in *Doyle* v. *Mitchell Bros. Co.*, 247 U. S. 179, 62 L. Ed. 1054; *Merchants Loan & Trust Co.* v. *Smietanka*, 255 U. S. 509, 65 L. Ed. 751; *Goodrich* v. *Edwards*, 255 U. S. 527, 65 L. Ed. 758; and kindred cases. No question of paramount or general importance is presented which requires this Court to review its well settled opinions on this branch of the law, which must now be regarded as elementary in the interpretation of our Federal income taxing statutes enacted since the adoption of the Sixteenth Amendment to the Constitution.

The second situation involves the inheritance in 1917 by Respondent from her mother of an interest in this same promise to pay in the future to the extent of 550/4000ths of the total. For the purpose of imposing the Federal estate tax this interest was valued by the Government at $277,164.50. The Circuit Court of Appeals below correctly held that as to this interest inherited, in view of the express exemption granted by the statute, no part of the payments subsequently received by virtue of the inheritance constituted income until the full value of the amount inherited had been received by respond-

ent. Manifestly there is nothing new or novel in this ruling which is in strict accord with the express exemption granted by the Revenue Act of 1918, Sec. 213(b) 3, providing that the value of property acquired by gift, bequest, devise or descent shall be excluded from gross income.

II. *With respect to the inherited interest, there is no conflict of opinion and no basis for the issuance of a writ of certiorari. If a writ is issued because of conflicting opinions, this question should be excluded.*

The opinion of the Circuit Court of Appeals for the Sixth Circuit in the case of *Frank Hitchcock* v. *Commissioner*, set out in Petitioner's Memorandum, is in conflict with the opinion of the Circuit Court of Appeals for the Second Circuit in the present case only with respect to the first transaction above stated.

Contrary to the statement of counsel for petitioner (page 6 of Petitioner's Brief), an examination of the memorandum opinion of the Circuit Court of Appeals for the Sixth Circuit does not show that the Court in anywise considered or passed upon any question of inherited interest, such as is involved in the second situation above mentioned.

The answer to the second question seems clear and does not carry the general importance attributed to it by Government counsel. If it could have such importance, it is strange that the Government should have waited to this late date before applying for certiorari in view of the several opportunities open to it beforehand on what are now called similar questions in *Warner* v. *Walsh*, and related cases (see *infra*).

The thing inherited is a 550/4000ths interest in a right to future payments. The Government has singularly failed to include among the applicable provisions of the statutes, the Revenue Act of 1918, Section 213(b) (3):

> "Sec. 213. That for the purposes of this title (except as otherwise provided in section 233) the term 'gross income' * * * (b) Does not include the following items, which shall be exempt from taxation under this title: (3)

> The value of property acquired by gift, bequest, devise, or descent (but the income from such property shall be included in gross income)."

The Government has plainly overlooked the fact that what the respondent received was *bequest*, not income from a bequest. As bequest, it is specifically exempt from taxation.

Three Circuit Courts of Appeals have successively held that payments made under a will to a widow in lieu of dower are purchases of the interest under the will and that the value of the dower interest surrendered should be fully restored before any part of the payments can be regarded as income. *Warner* v. *Walsh*, 15 Fed. (2d) 367 (C. C. A. 2d); *United States* v. *Bolster*, 26 Fed. (2d) 760 (C. C. A. 1st); *Allen* v. *Brandeis*, 29 Fed. (2d) 363 (C. C. A. 8th). Certiorari was not applied for in any one of these cases.

The Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, accepted all of these cases as representing sound law. See respectively, *T. D. 4257*, *4258* and *4256* in VIII–1 Cumulative Bulletin, 245, 247, 243. Is it not just as sound that the value of the bequest must be restored before any part of the receipt thereof can possibly be regarded as income in any sense? Is not the decision below even stronger in view of Section 213(b) (3) above quoted?

In *Nichols* v. *Coolidge*, 64 Ct. Cls. 214, it was held that an executor collecting payments due to an estate did not receive income except to the extent that payments received exceeded the value at the date of death of the decedent. The Government applied for a writ of certiorari, but the petition was denied. 277 U. S. 584. The Board of Tax Appeals has repeatedly held in accordance with this decision, and the Commissioner of Internal Revenue has indicated by formal acquiescence that he accepted the principle laid down. *McCarthy, Ex'r*, v. *Commissioner*, 9. B. T. A. 525, Acq., VII–2 C. B. 26; *Hearn, Admx.*, v. *Commissionr*, 9 B. T. A. 1362, Acq. VII–2 C. B. 17; *Brown et al.* v. *Commissioner*, 10 B. T. A. 1036, Acq. VII–2 C. B. 5; *Nichols, Ex'r*, v. *Commissioner*, 10 B. T. A. 919, Acq. VII–2 C. B. 29, and other cases. The Commissioner has even pub-

lished rulings to the same effect. *I. T. 1383, I-2 C. B. 157; O. D. 1112, 5 C. B. 55; I. T. 1563, II-1 C. B. 49; G. C. M. 4983, VII-2 C. B. 136.*

Is a legatee in a worse position than the executor in view of Section 213(b) (3), exempting his bequest from taxation? This is apparently the first effort to impinge upon the express statutory exemption of bequests. No injustice is done to the United States, for a Federal Estate Tax was paid on the inheritance. On the same inheritance, the Government now asks for an *income tax*, without noting that it had already collected an estate tax on the same thing as an asset of the estate. The collection of the amount inherited was not a "sale or disposition" of the bequest. Adequate provision is made when income tax is paid on the amounts received in excess of the value of the bequest.

As to this branch of the case, which is a separate and distinct issue, it seems plain that there is no basis for certiorari. The importance is wholly imaginary, since there are no other cases involving such a principle and since to counsel's knowledge there has never been such a contention advanced in any other case. This Court denied the petition of the United States in *Nichols* v. *Coolidge*, where it tried to bring practically the same question before the Court. It is noteworthy, too, that an examination of the petitioner's brief in the Second Circuit fails to show that any sort of distinction was made by counsel between the amount received by bequest and the amount received as part of the purchase price of stock sold, and certiorari on this point would therefore be a review of a contention never made by the Government below.

We submit that on this point there is no direct conflict of decision, and certiorari, if granted, should be limited to the question of taxability, if any, of the payments for the transfer of the 250 shares.

III. *With respect to the sale of the stock the Court below has correctly held that no taxable income was received until there has been a return of Respondent's statutory base, to wit, the March 1, 1913, value of the shares sold. There*

is nothing new or novel in this, and certiorari should be denied, notwithstanding the conflicting opinion on this branch of the case by the Circuit Court of Appeals for the Sixth Circuit in Hitchcock v. *Commissioner of Internal Revenue.*

The decision below of the Circuit Court of Appeals for the Second Circuit on this branch of the case, we submit, is plainly correct. It states nothing new or novel in the application of the elementary principles governing the interpretation of our Federal income taxing statutes enacted since the adoption of the Sixteenth amendment to the Constitution. The elementary principles as applied by the Circuit Court of Appeals to the question of determining the gain or loss to respondent, on the sale of the stock, are in strict accord with the rulings of this Court. This Court has uniformly held that in determining gain or loss arising from a sale of stock or other capital assets, a taxpayer has a right to have restored to him the March 1, 1913, value of the stock or capital assets sold. *Goodrich* v. *Edwards*, 255 U. S. 527, 65 L. Ed. 758. Here, concededly, the total amount of the payments received by respondent since the sale of her 250 shares of stock, from the date of the sale down to and including the last taxable year in question, was less than the value on March 1, 1913, of the shares sold.

The chief source of confusion is that the Sixth Circuit gives no significance to the fact that respondent sold 250 share of stock and received in part cash and in part a promise to pay in the future, dependent on certain contingencies. When and as that promise is performed, there is not a second transaction; there is simply performance on the part of the purchaser. See *W. B. Geary* v. *Commissioner*, 6 B. T. A. 1109, 1112. There is but one sale; *one* disposition and that is a sale of stock. By fine spun theories of capitalization, the Sixth Circuit converts this simple transaction into two transactions: (1) a sale of the stock; (2) a disposition of the so-called contract right. The weakness of the whole case inheres in this theory of analysis.

The Sixth Circuit unqualifiedly accepted the Government analysis, which is as follows:

(1) The promise to make these future payments is a chose in action, has a present market value and is the equivalent of cash to the extent of $1,942,111.46, determined by making a series of assumptions and prophecies, and then applying Hoskold's formula. That, therefore, the sale of this stock is a closed and completed transaction, giving rise to gain or loss in the year 1916, as an exchange of property for property.

(2) That this value of $1,942,111.46 added to the cash payment of $2,200,000 is less than the March 1, 1913, value of the stock sold and greater than the cost of the stock sold, and, therefore, no gain is derived and, on the other hand, no loss is sustained because of this transaction in 1916.

(3) A new basis is formed by the acquisition of this contract right to future payments, which is "disposed of or sold," evidenced by the receipt of cash in each year. This disposition, as and when it is made, results in the derivation of income in part and in part constitutes the return of the value of the contract so disposed of, spread over the period in which it is assumed that payments will be made.

Respondent sold stock, not a contract right. The only question is: Did she make a *profit* or derive a gain from the sale of the stock and when did she receive that gain? Respondent reported income on the cash basis—as and when she received it. To say that a promise to pay in the future is a present receipt in 1916 to a person on the cash basis is bad accounting and confuses the accrual system of accounting with the cash receipts basis.

This Court very pointedly stated in *Commissioner* v. *American Code Co., Inc.*, decided February 24, 1930, 280 U. S. 445, 449; 74 L. Ed. 538, 540:

> "Generally speaking, the income-tax law is concerned only with realized losses, as with realized gains. Weiss *v.* Weiner, 279 U. S. 333, 335. * * * The general requirement that losses be deducted in the year in which they are sustained calls for a practical, not a legal, test. * * *"

See *Columbia State Savings Bank* (C. C. A. 7th), decided June 10, 1930, 41 Fed. (2d) 923, for the distinction between treating accrued income on notes between a taxpayer on the cash basis and a taxpayer on the accrual basis.

By a complicated analysis, what was intended to be a simple transfer of title to personal property for a promise to pay in the future is turned into two separate and distinct conversions and dispositions of property.

The Court then goes on to discuss "exhaustion of contract" and "return of capital" as if this were the case of a mine. The transaction here is a sale of stock. No profit is realized on *any* sale or disposition of property until the *cost* is recovered. This would seem to be elementary. If authority is necessary, see: *Doyle* v. *Mitchell Bros. Co.*, 247 U. S. 179, 183; 62 L. Ed. 1054, 1059; *Bowers* v. *Kerbaugh-Empire Co.*, 271 U. S. 170, 175; 70 L. Ed. 886, 888; *Lucas* v. *Alexander*, 279 U. S. 573, 577; 73 L. Ed. 851, 854; *United States* v. *Guggenheim Exploration Co.*, 238 Fed. 231; *Safe Deposit & Trust Co. of Baltimore* v. *Miles*, 273 Fed. 822, 824; *Mastin* v. *Commissioner*, 28 Fed. (2d) 748, (C. C. A. 8th). To find any gain before cost is recouped, not only offends common reasoning, but violates the Sixteenth Amendment to the Constitution, which taxes income only.

The Sixth Circuit assumed that attacks were being made upon its decision in *Eldredge* v. *Commissioner*, 31 Fed. (2d) 924. The case is not near the point. It involved the restoration of March 1, 1913, value of a contract right. *There was no question of gain or loss on the transaction.* By referring the subsequent receipts to March 1, 1913, value, the Court thereby premised that the entire receipts would be *income* except for the interpretation of the Sixteenth Amendment which absolves from income taxation all income accrued prior to March 1, 1913, but received subsequent thereto. That is not this case. This Court in *Lucas* v. *Alexander*, 279 U. S. 573, 580; 73 L. Ed. 851, 855, pointed out that there must first be a profit or a gain before March 1, 1913, value becomes material at all:

> "* * * For the necessity of ascertaining value as of March 1, 1913, can never arise until some later date when

> income has been produced by converting the property into money or money's worth and the amount actually realized is known, and then, as we have said, only for the purpose of apportioning the total gain which has accrued between the periods before and after March 1, 1913."

If the same principle is here applied, it was necessary for the Sixth Circuit, first of all, to find a realized gain. To call the deferred payments "an income-producing contract," begs the question. Cost must first be returned. There can be no gain until there has been recompense for the sacrifice made to secure it. "Income can not be created by fiat alone," said the Sixth Circuit in *Taplin* v. *Commissioner*, decided June 12, 1930, 41 Fed. (2d) 454.

Contingent rights are not capital and are not susceptible of valuation for determining gain or loss. *Workman* v. *Commissioner* (C. C. A. 7th), decided May 28, 1930, 41 Fed. (2d) 139. Compare a statement by the Sixth Circuit itself in *Morris Poston Coal Co.* v. *Commissioner* (C. C. A. 6th), decided June 28, 1930, Vol. 3, Federal Tax Service C. C. H., Par. 9465, that contingent rights subsequently paid do not and can not create income before payment.

The Court fails to point out any basis for exhausting the *value* of a contract right. In every other instance, *cost* is the basis for exhaustion, depletion and depreciation. Value and cost are not synonymous or even similar. The cost here is the value of the *stock* at March 1, 1913, since said stock was acquired before March 1, 1913. On the Court's own statement, there would be no taxable income on that basis:

> "* * * Consequently, if the capital value which petitioner is entitled to have returned is the value of the Andrews Company stock as of March 1, 1913, there is no showing of any tax liability for any of the years here involved. * * *"

This discussion need not be extended to examine the question of the marketability of such a promise to make future payments; to examine the assumptions on the basis of which the Government applied Hoskold's formula; to examine what

application such a formula could possibly have in determining gain or loss on the sale of stock; to examine why by this scheme of a "double sale" the Government deprives a taxpayer of a large amount representing the difference between the March 1, 1913, value of the stock (admittedly in excess of what was received in 1916), and the so-called value of this contract.

IV. *In the case of* Commissioner *v.* Garber, *now pending in the Circuit Courts of Appeals for the Ninth and Tenth Circuits, the Government is taking precisely the same position which it is asking this Court to reverse in this case.*

The case of *Garber* v. *Commissioner*, 11 B. T. A. 979, was decided by the Board of Tax Appeals on May 3, 1928. In 1918, Garber and others sold stock in an oil company for $500,000 cash, plus 200 oil and gas certificates calling for 20 per cent of the total gross receipts from the sale of all oil produced from the leases then owned by the oil company. The certificates were secured. On the same day, Garber and the others (under the form of an option) sold all the oil and gas certificates to the Sinclair Company for $2,500,000 to be paid over five years. The Government's contention in that case, as stated by the Board, was as follows (pages 985–6):

> "He (the Commissioner) determined that the taxable income should be ascertained by applying the consideration from the first and second transactions to the cost of the Garfield stock which was sold or exchanged in the first transaction. This application was made on the 'return of capital' theory, which contemplates the receipt by the taxpayer of his entire cost before there can be taxable income. The petitioners contend that the first of the transactions is complete in itself and that the income therefrom should be determined in accordance with the provisions of section 202(b) of the Revenue Act of 1918 * * *.
>
> "We think that the petitioners' contention is correct. There were two transactions, each separate and distinct from the other and each giving rise to income. When, in 1918, the petitioners sold or exchanged their Garfield stock for $500,000 in cash and the 200 certificates, they received cash and property having a fair market value

and derived income therefrom, the amount of which is immaterial here since the year 1918 is not before us. They derived no income from that transaction in the subsequent years."

The Government lost and appealed the cases. (See Vol. IV, Standard Federal Tax Service, page 3054, paragraph 719:16). The position which it is trying to establish in the Circuit Courts of Appeals is that the transaction was not "closed and completed" in 1918. Yet in those cases the Government is attempting to establish the very result and the same conclusion which it is asking this Court to review in the opinion of the Circuit Court of Appeals for the Second Circuit.

In fact, the Board cited (page 986) as analogous situations, *Kosmerl* v. *Commissioner*, 25 Fed. (2d) 87, and *Ruth Iron Company* v. *Commissioner*, 4 B. T. A. 1151, which have been and are relied on by the Government in the instant case. (See Petitioner's Brief, page 13.)

We submit that petition for certiorari in this case is not an effort to settle any general principles of taxation but is simply an effort to overcome an adverse decision below.

The decision of the Circuit Court of Appeals for the Second Circuit is in strict accord with the principles uniformly laid down by this Court in the cases which have come before it since the adoption of the Sixteenth Amendment to the Constitution, involving the determination of gain or loss on the sale of stock or capital assets, and, as no new or novel questions are presented, we submit it does not require review by this Honorable Court.

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